

109TH CONGRESS
2D SESSION

S. 4030

To amend the Internal Revenue Code of 1986 to simplify certain provisions applicable to real estate investment trusts, and for other purposes.

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 29, 2006

Mr. HATCH introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to simplify certain provisions applicable to real estate investment trusts, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “REIT Investment Di-
5 versification and Empowerment Act of 2006”.

6 **SEC. 2. AMENDMENT OF 1986 CODE.**

7 Except as otherwise expressly provided, whenever in
8 the Act an amendment or repeal is expressed in terms of
9 an amendment to, or repeal of, a section or other provi-
10 sion, the reference shall be considered to be made to a

1 section or other provision of the Internal Revenue Code
2 of 1986.

3 **TITLE I—FOREIGN CURRENCY**
4 **AND OTHER QUALIFIED AC-**
5 **TIVITIES**

6 **SEC. 101. REVISIONS TO REIT INCOME TESTS.**

7 (a) ADDITION OF PERMISSIBLE INCOME CAT-
8 EGORIES.—Section 856(c) (relating to limitations) is
9 amended—

10 (1) by striking “and” at the end of paragraph
11 (2)(G) and by inserting after paragraph (2)(H) the
12 following new subparagraphs:

13 “(I) passive foreign exchange gains; and

14 “(J) any other item of income or gain as
15 determined by the Secretary;”, and

16 (2) by striking “and” at the end of paragraphs
17 (3)(H) and (3)(I) and by inserting after paragraph
18 (3)(I) the following new subparagraphs:

19 “(J) real estate foreign exchange gains;
20 and

21 “(K) any other item of income or gain as
22 determined by the Secretary; and”.

23 (b) RULES REGARDING FOREIGN CURRENCY TRANS-
24 ACTIONS.—Section 856 (defining real estate investment

1 trust) is amended by adding at the end the following new
 2 subsection:

3 “(n) RULES REGARDING FOREIGN CURRENCY
 4 TRANSACTIONS.—With respect to any taxable year—

5 “(1) REAL ESTATE FOREIGN EXCHANGE
 6 GAINS.—For purposes of subsection (c)(3)(J), the
 7 term ‘real estate foreign exchange gains’ means—

8 “(A) foreign currency gains (as defined in
 9 section 988(b)(1)) which are attributable to—

10 “(i) any item described in subsection
 11 (c)(3),

12 “(ii) the acquisition or ownership of
 13 obligations secured by mortgages on real
 14 property or on interests in real property
 15 (other than foreign currency gains de-
 16 scribed in clause (i)), or

17 “(iii) becoming or being the obligor
 18 under obligations secured by mortgages on
 19 real property or on interests in real prop-
 20 erty (other than foreign currency gains de-
 21 scribed in clause (i)),

22 “(B) gains described in section 987 attrib-
 23 utable to a qualified business unit (as defined
 24 by section 989) of the real estate investment

1 trust, but only if such qualified business unit
 2 meets the requirements under—

3 “(i) subsection (c)(3) for the taxable
 4 year; and

5 “(ii) subsection (c)(4)(A) at the close
 6 of each quarter that the real estate invest-
 7 ment trust has directly or indirectly held
 8 the qualified business unit, and

9 “(C) any other foreign currency gains as
 10 determined by the Secretary.

11 “(2) PASSIVE FOREIGN EXCHANGE GAINS.—For
 12 purposes of subsection (c)(2)(I), the term ‘passive
 13 foreign exchange gains’ means—

14 “(A) gains described under paragraph (1),

15 “(B) foreign currency gains (as defined in
 16 section 988(b)(1)) which are attributable to any
 17 item described in subsection (c)(2) (other than
 18 those items includible under subparagraph (A)),
 19 and

20 “(C) any other foreign currency gains as
 21 determined by the Secretary.”.

22 (c) ADDITION TO REIT HEDGING RULE.—Subpara-
 23 graph (G) of section 856(c)(5) is amended to read as fol-
 24 lows:

1 “(G) TREATMENT OF CERTAIN HEDGING
2 INSTRUMENTS.—Except to the extent as deter-
3 mined by the Secretary—

4 “(i) any income of a real estate in-
5 vestment trust from a hedging transaction
6 (as defined in clause (ii) or (iii) of section
7 1221(b)(2)(A)) which is clearly identified
8 pursuant to section 1221(a)(7), including
9 gain from the sale or disposition of such a
10 transaction, shall not constitute gross in-
11 come under paragraphs (2) and (3) to the
12 extent that the transaction hedges any in-
13 debtedness incurred or to be incurred by
14 the trust to acquire or carry real estate as-
15 sets, and

16 “(ii) any income of a real estate in-
17 vestment trust from a transaction entered
18 into by the trust primarily to manage risk
19 of currency fluctuations with respect to
20 any item described in paragraphs (2) and
21 (3), including gain from the termination of
22 such a transaction, shall not constitute
23 gross income under paragraphs (2) and
24 (3), but only if such transaction is clearly
25 identified as such before the close of the

1 day on which it was acquired, originated,
 2 or entered into (or such other time as the
 3 Secretary may prescribe).”.

4 (d) AUTHORITY TO EXCLUDE ITEMS OF INCOME
 5 FROM REIT INCOME TESTS.—Section 856(c)(5) is
 6 amended by adding at the end the following new subpara-
 7 graph:

8 “(H) SECRETARIAL AUTHORITY TO EX-
 9 CLUDE OTHER ITEMS OF INCOME.—The Sec-
 10 retary is authorized to determine whether any
 11 item of income or gain which does not otherwise
 12 qualify under paragraph (2) or (3) may be con-
 13 sidered as not constituting gross income solely
 14 for purposes of this part.”.

15 **SEC. 102. REVISIONS TO REIT ASSET TESTS.**

16 (a) CLARIFICATION OF VALUATION TEST.—The first
 17 sentence in the matter following section
 18 856(c)(4)(B)(iii)(III) is amended by inserting “(including
 19 a discrepancy caused solely by the change in the foreign
 20 currency exchange rate used to value a foreign asset)”
 21 after “such requirements”.

22 (b) CLARIFICATION OF PERMISSIBLE ASSET CAT-
 23 EGORY.—Section 856(c)(5), as amended by section
 24 101(d), is amended by adding at the end the following new
 25 subparagraph:

1 “(I) CASH.—For purposes of this part, the
 2 term ‘cash’ includes foreign currency if the real
 3 estate investment trust or its qualified business
 4 unit (as defined in section 989) uses such for-
 5 eign currency as its functional currency (as de-
 6 fined in section 985(b)).”.

7 **SEC. 103. CONFORMING FOREIGN CURRENCY REVISIONS.**

8 (a) NET INCOME FROM FORECLOSURE PROPERTY.—
 9 Clause (i) of section 857(b)(4)(B) is amended to read as
 10 follows:

11 “(i) gain (including any foreign cur-
 12 rency gain, as defined in section 988(b)(1))
 13 from the sale or other disposition of fore-
 14 closure property described in section
 15 1221(a)(1) and the gross income for the
 16 taxable year derived from foreclosure prop-
 17 erty (as defined in section 856(e)), but
 18 only to the extent such gross income is not
 19 described in (or, in the case of foreign cur-
 20 rency gain, not attributable to gross in-
 21 come described in) section 856(c)(3) other
 22 than subparagraph (F) thereof, over”.

23 (b) NET INCOME FROM PROHIBITED TRANS-
 24 ACTIONS.—Clause (i) of section 857(b)(6)(B) is amended
 25 to read as follows:

“(i) the term ‘net income derived from prohibited transactions’ means the excess of the gain (including any foreign currency gain, as defined in section 988(b)(1)) from prohibited transactions over the deductions (including any foreign currency loss, as defined in section 988(b)(2)) allowed by this chapter which are directly connected with prohibited transactions;”.

TITLE II—TAXABLE REIT SUBSIDIARIES

SEC. 201. CONFORMING TAXABLE REIT SUBSIDIARY ASSET TEST.

Section 856(c)(4)(B)(ii) is amended by striking “20 percent” and inserting “25 percent”.

TITLE III—DEALER SALES

SEC. 301. HOLDING PERIOD UNDER SAFE HARBOR.

Section 857(b)(6) (relating to income from prohibited transactions) is amended—

- (1) by striking “4 years” in subparagraphs (C)(i), (C)(iv), and (D)(i) and inserting “2 years”,
- (2) by striking “4-year period” in subparagraphs (C)(ii), (D)(ii), and (D)(iii) and inserting “2-year period”, and

1 (3) by striking “real estate asset” and all that
 2 follows through “if” in the matter preceding clause
 3 (i) of subparagraphs (C) and (D) and inserting “real
 4 estate asset (as defined in section 856(c)(5)(B) oth-
 5 erwise described in section 1221(a)(1) if”.

6 **SEC. 302. DETERMINING VALUE OF SALES UNDER SAFE**
 7 **HARBOR.**

8 Subparagraphs (C)(iii)(II) and (D)(iv)(II) of section
 9 857(b)(6) are each amended by striking “the aggregate
 10 adjusted bases” and all that follows through “the begin-
 11 ning of the taxable year” and inserting “the fair market
 12 value of property (other than sales of foreclosure property
 13 or sales to which section 1033 applies) sold during the
 14 taxable year does not exceed 10 percent of the fair market
 15 value of all of the assets of the trust as of the beginning
 16 of the taxable year”.

17 **TITLE IV—HEALTH CARE REITS**

18 **SEC. 401. CONFORMITY FOR HEALTH CARE FACILITIES.**

19 (a) RELATED PARTY RENTALS.—Subparagraph (B)
 20 of section 856(d)(8) (relating to special rule for taxable
 21 REIT subsidiaries) is amended to read as follows:

22 “(B) EXCEPTION FOR CERTAIN LODGING
 23 FACILITIES AND HEALTH CARE PROPERTY.—
 24 The requirements of this subparagraph are met
 25 with respect to an interest in real property

1 which is a qualified lodging facility or a quali-
 2 fied health care property (as defined in sub-
 3 section (e)(6)(D)(i)) leased by the trust to a
 4 taxable REIT subsidiary of the trust if the
 5 property is operated on behalf of such sub-
 6 sidiary by a person who is an eligible inde-
 7 pendent contractor.”.

8 (b) ELIGIBLE INDEPENDENT CONTRACTOR.—Sub-
 9 paragraphs (A) and (B) of section 856(d)(9) (relating to
 10 eligible independent contractor) are amended to read as
 11 follows:

12 “(A) IN GENERAL.—The term ‘eligible
 13 independent contractor’ means, with respect to
 14 any qualified lodging facility or qualified health
 15 care property (as defined in subsection
 16 (e)(6)(D)(i)), any independent contractor if, at
 17 the time such contractor enters into a manage-
 18 ment agreement or other similar service con-
 19 tract with the taxable REIT subsidiary to oper-
 20 ate such qualified lodging facility or qualified
 21 health care property, such contractor (or any
 22 related person) is actively engaged in the trade
 23 or business of operating qualified lodging facili-
 24 ties or qualified health care properties, respec-
 25 tively, for any person who is not a related per-

1 son with respect to the real estate investment
2 trust or the taxable REIT subsidiary.

3 “(B) SPECIAL RULES.—Solely for purposes
4 of this paragraph and paragraph (8)(B), a per-
5 son shall not fail to be treated as an inde-
6 pendent contractor with respect to any qualified
7 lodging facility or qualified health care property
8 (as so defined) by reason of the following:

9 “(i) The taxable REIT subsidiary
10 bears the expenses for the operation of
11 such qualified lodging facility or qualified
12 health care property pursuant to the man-
13 agement agreement or other similar service
14 contract.

15 “(ii) The taxable REIT subsidiary re-
16 ceives the revenues from the operation of
17 such qualified lodging facility or qualified
18 health care property, net of expenses for
19 such operation and fees payable to the op-
20 erator pursuant to such agreement or con-
21 tract.

22 “(iii) The real estate investment trust
23 receives income from such person with re-
24 spect to another property that is attrib-
25 utable to a lease of such other property to

1 such person that was in effect as of the
2 later of —

3 “(I) January 1, 1999, or

4 “(II) the earliest date that any
5 taxable REIT subsidiary of such trust
6 entered into a management agreement
7 or other similar service contract with
8 such person with respect to such
9 qualified lodging facility or qualified
10 health care property.”.

11 **TITLE V—FOREIGN REITS**

12 **SEC. 501. STOCK OF FOREIGN REITS AS REAL ESTATE AS-** 13 **SETS.**

14 (a) IN GENERAL.—The first sentence in section
15 856(c)(5)(B) is amended by inserting “or in a qualified
16 foreign REIT” after “this part”.

17 (b) QUALIFIED FOREIGN REIT.—Section 856(c) is
18 amended by adding at the end the following new para-
19 graph:

20 “(8) QUALIFIED FOREIGN REIT.—For purposes
21 of this subsection, the term ‘qualified foreign REIT’
22 means a corporation, trust, or association—

23 “(A) treated as a corporation under section
24 7701(a)(3),

1 “(B) the shares or certificates of beneficial
2 interests of which are regularly traded on an es-
3 tablished securities market, and

4 “(C) which is organized in a country under
5 rules that the Secretary determines meet the
6 following criteria:

7 “(i) At least 75 percent of the entity’s
8 assets must qualify as real estate assets
9 (determined without regard to shares or
10 transferable certificates of beneficial inter-
11 est in such entity), as determined at the
12 close of the entity’s prior taxable year.

13 “(ii) The entity either receives a divi-
14 dends paid deduction comparable to section
15 561 or is exempt from corporate level tax.

16 “(iii) The entity is required to dis-
17 tribute at least 85 percent of its annual
18 taxable income (as computed in the juris-
19 diction in which it is organized) to the
20 holders of its shares or certificates of bene-
21 ficial interest on an annual basis.”.

22 **SEC. 502. DIVIDENDS FROM FOREIGN REITS.**

23 Section 856(c)(3)(D) is amended by inserting “and
24 in qualified foreign REITs” after “this part”.

1 **TITLE VI—EFFECTIVE DATES**

2 **SEC. 601. EFFECTIVE DATES.**

3 (a) IN GENERAL.—Except as otherwise provided in
4 this section, the amendments made by this Act shall apply
5 to taxable years beginning after the date of the enactment
6 of this Act.

7 (b) REIT HEDGING RULES.—The amendment made
8 by section 101(c) shall apply to transactions entered into
9 after the date of the enactment of this Act.

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